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(Editors: This is one of a series of op-ed pieces from the N.C. Center for Public Policy Research. The Center is an independent, nonpartisan, nonprofit organization dedicated to informing the public and making state government more effective and accountable. In 1983 and 1995 editions of *North Carolina Insight*, the Center published research on the North Carolina Railroad. This editorial is based on that research. For more information, contact Mike McLaughlin at the Center at 919-832-2839.

Federal Judge's Ruling Underscores Need for State to Buy Out Private Shareholders in N.C. Railroad
By Mike McLaughlin

Last week's federal court ruling that derailed the lease agreement between the North Carolina Railroad and Norfolk-Southern Corporation demonstrated yet again why the N.C. Railroad needs to change its ownership structure. The state owns three-fourths of the stock in the 317-mile rail line running from Charlotte to Morehead City. Private shareholders own the other one-fourth. The interests of the state and private shareholders are in direct conflict. No one disputes that the rail line is a valuable asset, but there is quite a bit of dispute about how that asset can best be used. And therein lies the rub.

The N.C. Railroad (NCRR) hasn't operated its own trains since the 19th Century, when it first began leasing the tracks to private operators -- and each such agreement has brought howls of protest from the private shareholders. A 99-year lease negotiated in 1895 was decried as "The Crime of a Century" on the front page of *The News & Observer* of Raleigh. History proved the headline wasn't far off the mark. The lease generated $694,277 in 1994 -- less than 1 percent of the railroad's assets.

Now a group of private shareholders is arguing that history is repeating itself. The state, they say, wants to keep lease rates low for economic development purposes. Private shareholders want to maximize profits, which means keeping lease rates high. Caught in the middle are the NCRR trustees, who have a fiduciary duty to negotiate the best lease they can for the corporation. In 1995, the trustees negotiated a 30-year lease at $8 million a year with adjustments for inflation, plus a one-time payment of $5 million, granting Norfolk-Southern an option for a 20-year renewal. The railroad also announced reorganization as a real estate investment trust (REIT), freeing it from state and local income taxes.

The deal was better than the one inked in 1895, but not good enough for a group of private shareholders led by Greensboro businessman Walker Rucker. Terming the proposal a sweetheart deal for the state, Rucker orchestrated a boycott of the annual shareholders meeting at which the lease was to be ratified. Railroad President John F. McNair III ruled that the railroad had a quorum, and the new lease was approved. But Rucker sued, and last week federal District Court Judge Terrence Boyle ruled in his favor. Boyle found that a majority of the private shareholders were not present or represented at the December 1995 shareholder meeting, thereby nullifying the agreement.

The dispute demonstrates yet again a simple fact. The railroad's current ownership structure doesn't work. That's the conclusion the N.C. Center for Public Policy Research reached in research published in the September 1995 edition of *North Carolina Insight.* Judge Boyles' ruling only strengthens the Center's recommendation that the state buy out the private shareholders and claim full ownership of the railroad.

Why buy the railroad? The railroad is an invaluable asset that plays a key role in moving freight, and it holds great potential for public transportation. But despite owning three-quarters of the railroad's stock, the state's role is that of a passive investor. U.S. Securities and Exchange Commission regulations require the state to take a hands-off stance in any lease negotiations, and the regulations cloak these negotiations in secrecy so no one can make sure the state's interests are represented.

But the state's interests are vital. The rail line links such Piedmont cities as Charlotte, Concord, Salisbury, High Point, and Greensboro. To the east, it connects Raleigh, Goldsboro, Kinston, and New Bern -- a less profitable link that is nonetheless vital to the state's economic well-being. The eastern leg provides the sole rail service to the Global TransPark facility in Kinston (the state's planned rail, highway, and air cargo hub) and to the state port in Morehead City. Two state-subsidized passenger trains -- the *Amtrak Carolinian* and the *Piedmont* -- currently operate on NCRR tracks between Charlotte and Raleigh. In addition, the stretch between Charlotte and Raleigh is part of one of five corridors designated nationally for high-speed rail. Tentative plans for commuter service in the Triangle also depend upon use of NCRR tracks. But the railroad's ownership structure keeps it from realizing its full potential. And it now appears the railroad can't even negotiate a lease that can be ratified.

The best way to get the North Carolina Railroad back on track is to straighten out its ownership structure. The NCRR board of directors should buy out the private shareholders in the company so the state can take maximum advantage of this valuable asset in the formation of transportation and economic development policy. The board should use revenue from the rail lease to accomplish the purchase -- without spending state tax money -- through issuance of revenue bonds or a similar financing vehicle.

By buying out the private shareholders, the state could gain four key advantages. It could: (1) have full control over the future of the rail corridor and negotiate to keep vital but less profitable rail links open in eastern North Carolina; (2) make future lease negotiations more open to public scrutiny and debate; (3) negotiate for lower lease rates if necessary as a catalyst for economic development or press for a higher rate to subsidize public transportation; and (4) accommodate passenger service in the terms of any lease.

A key disadvantage is cost. It would take a minimum of $25 million and perhaps as much as $65 million to buy out the private shares. But by using the lease revenue to pay for the purchase, the state could obtain full control over a tremendous public asset with little or no expenditure of tax dollars. That would be a sweetheart deal for the investors who deserve it most -- North Carolina's taxpayers.

Two North Carolina governors -- former Gov. Jim Martin (1985-1993) and Gov. Jim Hunt (1976-85, 1993-present) -- the Council of State, and a study committee headed by C.C. Cameron, retired chairman of First Union Corporation, all have recommended that the state buy out the private shareholders. The governor appoints 10 of the 15 railroad's board members. He needs to take the lead in moving the buyout further down the tracks. So write Governor Hunt and let him know what you think about the issue. The address: Office of the Governor, 116 West Jones Street, Raleigh, N.C. 27603-8001 or call (919) 733-5811.

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